

FOREIGN POLICY REPORTS

April 1, 1937

Can War Profits Be Eliminated?

BY HAROLD TOBIN and R. L. BUELL

PUBLISHED TWICE A MONTH BY THE

Foreign Policy Association, Incorporated

EIGHT WEST FORTIETH STREET, NEW YORK, N. Y.

VOLUME XIII NUMBER 2 25¢ a copy \$5.00 a year

Can War Profits Be Eliminated?

BY HAROLD TOBIN and R. L. BUELL

with the aid of the Research Staff of the Foreign Policy Association

Mr. Tobin is a member of the Political Science Department at Dartmouth College

CONGRESS is now considering a number of bills ostensibly designed "to take the profit out of war." According to the "statement of intention" embodied in one of these measures—the Nye bill—it is the intention of Congress that no one shall profit in any manner whatsoever from the conduct of any war to which the United States may be a party. It is the intention of Congress to protect from inflation our economic organization in wartime and to finance the conduct of the war out of current revenue. Finally, it is the intention to subject industrial management to conscription, as well as man power.

Veterans returning after the Armistice were impressed by the fact that the war, which had increased the national debt to 30 billion dollars and in many cases left the veterans without jobs, had also created 22,000 new millionaires. Many shared the belief that wars are caused in part by the desire of certain capitalists to acquire large fortunes.

MUNITIONS PRODUCTION AND THE WORLD WAR

In its extensive hearings the Senate Munitions Committee uncovered many abuses connected with the production of munitions and other war supplies during the World War. It was necessary to rely to a large extent on private industry for such purposes, and it is charged that in compensating industry for the manufacture of munitions, the government tended to err on the liberal side. In many cases compensation was based on estimated costs—a system which encouraged manufacturers to make high estimates. During the World War, moreover, neither the War nor Navy Department had an adequate staff to audit the thousands of contracts required;¹⁻³ and the existing personnel

encountered many difficulties in securing information on which to base their decisions. These difficulties were increased by the unwillingness of many contractors, in some cases openly voiced by their representatives, to cooperate with the government. To supplement their auditing personnel, the defense departments were obliged to turn to industry, and civilians were sometimes called on to arrange terms on behalf of the government with the industries from which they were drawn, and to which they expected to return after the war.⁴ The government had the power to commandeer the plants of recalcitrant industrialists; but the threat of commandeering was weakened by the knowledge that the courts were inclined to be generous in assessing the "just compensation" due to owners, and that the government might be unwilling to face the problems involved in developing its own manufacturing facilities as an alternative.⁵ Thus it is believed that the government did not get a "fair deal" from industry in a number of important contracts, and that much profiteering was permitted out of fear of a "strike" of capital.

To prevent the recurrence of such abuses and to limit wartime profits in general, the American Legion early proposed a universal but unspecific draft of resources and man power for the next war, giving the President power to commandeer industrial resources and fix prices. Representatives Johnson and McSwain pushed the plan in the House, and Senator Capper in the Senate. Beginning in 1922, resolutions to this effect were introduced in one or both houses at each session.

In 1930 Congress authorized the appointment of

1-3. U. S. Congress, Senate, *Hearings Before the Special Committee Investigating the Munitions Industry*, 73d Congress, 2nd session (Washington, D. C., Government Printing Office, 1934-1936), p. 4274. Hereafter cited as *Munitions Industry, Hearings*. Cf. also *ibid.*, *Naval Shipbuilding, Preliminary Report*, pp. 35 *et seq.* Hereafter cited as *Munitions Industry, Shipbuilding Report*.

4. *Munitions Industry, Hearings*, cited, p. 3997; *Munitions Industry, Shipbuilding Report*, cited, p. 364.

5. U. S. Congress, Senate, *Special Committee on Investigation of the Munitions Industry, Preliminary Report on Wartime Taxation and Price Control*, 74th Congress, 1st session (Washington, D. C., Government Printing Office, 1935), pp. 112ff. Hereafter cited as *Munitions Industry, Wartime Taxation and Price Control*. Cf. Rose M. Stein, *M-Day* (New York, Harcourt, Brace, 1936), pp. 174ff.

FOREIGN POLICY REPORTS, VOLUME XIII, NUMBER 2, APRIL 1, 1937

Published twice a month by the FOREIGN POLICY ASSOCIATION, Incorporated, 8 West 40th Street, New York, N. Y., U.S.A. RAYMOND LESLIE BUELL, *President*; WILLIAM T. STONE, *Vice President and Washington representative*; VERA MICHELES DEAN, *Editor*; HELEN TERRY, *Assistant Editor*. *Research Associates*: T. A. BISSON, VERA MICHELES DEAN, HELEN FISHER, HELEN H. MOORHEAD, DAVID H. POPPER, ONA K. D. RINGWOOD, CHARLES A. THOMSON, M. S. WERTHEIMER, JOHN C. DEWILDE. Subscription Rates: \$5.00 a year; to F.P.A. members \$3.00; single copies 25 cents. Entered as second-class matter on March 31, 1931 at the post office at New York, N. Y., under the Act of March 3, 1879.

the War Policies Commission, composed of Cabinet members, Senators and Representatives, with power to hold hearings and present recommendations for measures to equalize the burdens of war and to minimize profits.⁶ In March 1932, after lengthy hearings at which the War Department submitted its mobilization plan, the commission recommended a constitutional amendment to provide specifically for Congressional power to prevent profiteering and to stabilize prices; and, pending such an amendment, advocated legislation granting the President authority to freeze prices at the outbreak of war, and to confiscate 95 per cent of all war incomes above "normal" to help defray war costs.

No immediate action was taken on the recommendations of the War Policies Commission. But finally, in April 1935, the House passed the McSwain bill (H.R. 5529), patterned after the ideas of Mr. Baruch and the American Legion, which authorized the President upon the outbreak of war to fix prices,⁷⁻⁸ and control and commandeer "material resources, industrial organizations and public services." The President was given the power to license any entrepreneur as a condition of continuing in business, and the imposition of an excess war profits tax of 100 per cent was also authorized.⁹ In September 1935 the Senate Munitions Committee began its hearings, which continued, with intermissions, until February 1936.¹⁰ In the course of its study of the abuses connected with industrial mobilization during the World War and the possibility of eliminating such abuses in the event of another major conflict, the committee examined the McSwain bill.

It gradually became evident that the question of taking the "profit out of war" was closely linked with industrial mobilization and preparedness. Although in 1917 the United States had probably the most advanced industrial organization in the world, it had made little military and even less industrial preparation for war. Despite a prodigious effort to reorganize peace time industry upon a war basis, few American planes or guns reached the Western front by the time of the Armistice.¹¹ The "conversion lag" between peace time and wartime production consumed at least eight months. Some military experts believe that

if, before the outbreak of war, the United States had followed the policy of "educational orders," under which private firms would have produced armament models at government request, the country would have saved at least three or four months' time in bringing munitions to quantity production.¹² Mr. Baruch declared before the War Policies Commission that the adoption of a proper mobilization plan would make it possible for the nation to return from a war to a peace time status with a "minimum of confusion, waste, and loss," and that such a plan would cut the cost of a war at least by half and reduce the prospect of inflation.¹³

In view of the nature of modern war,¹⁴ which involves a "totalitarian" effort, every general staff in the world is preoccupied with the task of industrial as well as military preparedness. In 1919, when he laid down his task as head of the War Industries Board, Mr. Baruch made a series of recommendations to the President for a more efficient supply of military needs. Chief among these was a suggestion for an industrial planning board, with members in charge of raw materials, finished products, prices and labor, who, with representatives of the Army, Navy, Shipping Board and other interested departments, would devise means to fill the requirements of these departments in time of war. A skeleton organization of munitions makers would produce sample orders in peace time, from machines for which the government would always maintain a supply of jigs, dies and tools.¹⁵ A "ceiling" would be fixed for prices,

11. Cf. Victor Lefebure, *Scientific Disarmament* (New York, Macmillan, 1931), pp. 49ff. Grosvenor B. Clarkson, *Industrial America and the World War* (Boston, Houghton Mifflin, 1933), p. 158.

12. Brigadier General Ruggles, quoted in J. M. Clark, *The Costs of the World War to the American People* (New Haven, Yale University Press, 1931), p. 265.

13. War Policies Commission, *Hearings before the Commission Appointed under the Authority of Public Resolution No. 98, 71st Congress, 2nd session* (Washington, D. C., Government Printing Office, 1931), p. 54.

14. For details of the war experience, cf. Crowell and Wilson, *Armies of Industry* (New Haven, Yale University Press, 1921), pp. 8-11; also Clarkson, *American Industry and the World War*, cited.

15. The National Defense Act of 1916 had contained a provision authorizing the expenditure of funds for the preparation of jigs, tools, gauges, and other aids to be utilized by private industry in peace time for experimental purposes, without the necessity of asking for bids. The United States entered the war, however, before this system of industrial preparedness could be put into effect. Congress, following the World War, consistently declined to make any appropriation for this purpose. It was feared that if the War Department had a fund to be distributed among private manufacturers, such a fund would be abused so as to constitute a veiled subsidy to industry and produce an alliance between private business interests and the War Department in favor of an ever-increasing

6. U. S. Congress, House of Representatives (74th Congress), Report No. 119 to accompany H.R. 5529, p. 15.

7-8. The final bill omitted the provision for a military draft contained in the original McSwain bill.

9. This bill, with certain modifications, became the Sheppard-Hill bill in the 75th Congress.

10. Cf. William T. Stone, "The Munitions Industry," *Foreign Policy Reports*, December 5, 1934.

based on a date at the beginning of the emergency when prices last appeared normal.¹⁶ In 1920 Congress amended the National Defense Act to provide for the immediate mobilization of the manpower and industrial resources of the nation in time of war, and specifically charged the Assistant Secretary of War with the task of assuring adequate provision of wartime supplies and the industrial mobilization¹⁷ necessary therefor, following the lines generally recommended by Baruch.

THE NEW MOBILIZATION PLAN

On the basis of these recommendations and under the authority of the 1916 and 1920 acts, the War Department set to work on a new industrial mobilization plan, based on the possible need for a large army and expeditionary force similar to that of 1917. Model wartime contract forms were drafted. An Army Industrial College was established, to which approximately fifty army officers were assigned annually for a year's duty. A complete industrial mobilization plan was evolved, ready whenever a war emergency should arise, dividing the nation into fourteen procurement districts. Colonel C. T. Harris, Jr., director of the planning branch of the War Department, has described the work already done in this connection as follows:

"The production capacity of the United States has been surveyed; the production capacity of some twenty thousand individual plants has been analyzed, and the capacity of these plants to manufacture war materials has been determined. Twelve thousand of these manufacturing plants have been allocated or assigned to one or more of the supply branches for the purpose of producing military supplies. In the case of each of these twelve thousand facilities, the War Department has completed or is now engaged in the process of acquainting them with the task that will be placed upon them in war. The manufacturing plant, after examination, states to the War Department whether or not it can be depended on to carry out the mission assigned to it with reference to both quantity and time. The great majority of these plants has signed a paper, known as the 'Accepted Schedule of Production,' which states they will be prepared to perform the work assigned. This 'Accepted Schedule' has no legal status and is not binding on either the government or the industrial plant. It simply means that the

preparedness program. Cf. testimony in favor of such orders of Mr. H. E. Coffin, War Policies Commission, *Hearings*, 1931, p. 292.

16. *Report of War Industries Board* (Washington, D. C., Government Printing Office, 1921), pp. 9 *et seq.*

17. 41 Stat. 759. Cf. W. T. Stone, "The National Defense Policy of the United States," *Foreign Policy Reports*, August 31, 1932.

industrial plant has cooperated with the government in studying and analyzing the war load that may be placed upon it, and is prepared to carry this load in war."¹⁸

Under the Industrial Mobilization Plan as presented to the Nye Committee for study, the Assistant Secretary of War was to be aided by an Advisory Defense Council composed of the heads of the several administrations set up to control the functioning of the plan. Under the supervision of the Council a War Resources Administration, a War Trade Administration, a War Labor Administration, and a Public Relations Administration were to be established, as well as a Selective Service Administration, a Price Control Commission, and a War Finance Control Commission. The President was to head all these agencies, and the War and Navy Departments were to be coordinated by a number of joint boards, such as the Army and Navy Munitions Board.¹⁹ Officers who had passed through the Army Industrial College were to serve as a nucleus for an administrative personnel.²⁰

In planning the industrial organization to supply military needs, the War Department regarded as its most important problems those dealing with mobilization of material, labor and capital, the protection of industry and the civil population from unnecessary hardship, and assurance of importation of necessary supplies not obtainable within the country. These problems were to be solved, it was stated, with a minimum of economic disturbance through minimum regulation.²¹ The first step was to arrange domestic procurement of the raw materials needed for the manufacture of the products planned for, on the assumption that imports from abroad might not be available. Committees similar to those functioning during the World War, were to prepare plans for each commodity.²² New plant construction was to be avoided, if possible, since it is costly and usually superfluous when war is over. Essential construc-

18. "Industry and National Defense," *Army Ordnance*, May-June 1936. The first portion of the so-called Load Directory was published last year. Cf. *Annual Report of the Secretary of War*, 1936 (Washington, D. C., Government Printing Office, 1936), p. 21.

19. This organization is the same as that of the 1936 mobilization plan. For the work of the Board, cf. Col. Eglin, "Army and Navy Munitions Board," *Army Ordnance*, March-April 1937.

20. U. S. Congress, Senate, *Industrial Mobilization Plan, Revised, 1933. A revision of the Industrial Mobilization Plan submitted by the War Department in 1931 to the War Policies Commission, etc.* (Washington, D. C., Government Printing Office, 1935).

21. *Ibid.*, p. 10.

22. *Ibid.*, p. 8.

tion, however, was to be supervised by the Assistant Secretary.²³

Priority control was to direct raw materials and service into war-making agencies and away from non-essential industries, and assure distribution of adequate supplies to possible allies and to the civilian population. Control would be maintained by a system of permits issued through the commodity committees, certifying the amount of essential raw materials to which any industry might be entitled.²⁴ Exports and imports would be put entirely in the hands of two bureaus in the Administration of War Trade, under a licensing system. Should complete control over supply and distribution of key raw materials be necessary as a means of stabilizing production, government-owned corporations or private associations under license would procure the entire available supply, while prices would be fixed or approved by a Price Control Committee.²⁵

A relationship between prices and profits was to be established by basing prices either on those under which the industry involved earned its profits over a specified pre-war period, on the costs of the most inefficient unit essential to the program, or on prevailing market prices, or on costs plus a "reasonable return" on capital investment.

But contractors were to be protected by the government against undue risks. Only heavy excess profits were to be taxed away, by unspecified means.²⁶ Commandeering would be resorted to as an enforcement measure only, as otherwise it would put the government into business.²⁷

In all its plans the War Department considered labor control essential to production control. Reduction of labor migrations, a primary wartime problem, was sought through regional allocation of war orders. "Unethical" competition for labor between war industries was to be prevented. The President was to be furnished with a list of labor deferments necessary to protect war industries, which he was to put into effect as he saw fit. A War Labor Administration was to be set up to carry out these aims, with an outstanding industrial leader as administrator—responsible directly to the President—and an advisory council of ten members, five representing industry and five labor.

To assure adequate legal authority, the plan included projects for seven legislative bills to be put before Congress at the outbreak of war, specifically granting the needed authority to govern-

ment agencies to carry out procurement along the above lines.²⁸⁻²⁹ These included a bill to draft the nation's man power, which authorized the President to exempt certain classes, including those engaged in essential industries. A second bill authorized a draft of the nation's material resources, giving the President power to fix prices, establish priorities, regulate supply, distribution, purchase and sale of commodities, and also giving him the right to license and requisition industry, make regulations against waste and hoarding, reorganize the Executive Department to accomplish any of these purposes and suspend restrictive legislation.

A third measure, serving partially as sanction for the second, authorized the President to take over and dispose of any property essential to the national security and defense and to determine just compensation therefor, subject to review by the courts. A fourth authorized the President to set up a Bureau of Marine War Risk Insurance.

Although the War Department insisted that its proposals would to a great extent equalize the burdens of war and eliminate profiteering on army contracts, it emphasized the view that the elimination of profiteering should not be allowed to interfere with effective industrial procurement and mobilization. According to the 1936 statement jointly issued by the War and Navy Departments, "it is conceivable that a war might be conducted with such great regard for individual justice and administrative efficiency as to make impossible those evils whose existence in past wars is well known. It is also conceivable that the outcome of a war so conducted might be defeat. In all plans for preparedness and policies to be pursued in event of war, it must never be overlooked that while efficiency in war is desirable, effectiveness is mandatory."³⁰ The plan as a whole envisaged the establishment of a complete dictatorship during wartime for the purpose of insuring the necessary production of munitions.

More interested in taking profit out of war than in industrial preparedness, the Senate Munitions Committee critically examined the industrial mobilization plans of the War Department.³¹ It de-

23. *Ibid.*, p. 9.

24. *Ibid.*, pp. 12, 24, 25.

25. *Ibid.*, pp. 11, 18, 63.

26. *Ibid.*, p. 67.

27. *Ibid.*, p. 11.

28-29. For texts, cf. U. S. Congress, Senate, *Hearings Before the Special Committee Investigating the Munitions Industry, Report on War Department Bills S. 1716-S. 1722 Relating to Industrial Mobilization in Wartime* (Washington, D. C., Government Printing Office, 1936), pp. 62ff. Hereafter cited as *Munitions Industry, Report on War Department Bills*.

30. *Industrial Mobilization Plan, Revised, 1936* (Washington, D. C., Government Printing Office, 1936), p. V.

31. In order to give Congress an unhurried opportunity to examine these plans, Senator Clark introduced the bills which the War Department had prepared but had intended to introduce only on the outbreak of war.

clared that the contemplated program was "very similar" in its essentials to that followed by the United States during the World War. The committee pointed out that the War Department had made no adequate provision for training personnel to pass on the thousands of contracts involved in procurement of war supplies. Although the Army Industrial College would provide a nucleus of men familiar with the plan itself, additional essential personnel would be drawn from the ranks of leading industrialists, many of whom are already reserve officers or members of ordnance district advisory boards.³²

After implying that the War Department had worked out its procurement plans without having adequate legislative authority,³³ the Munitions Committee expressed the view that the efforts of the Industrial Mobilization Plan to take the profit out of war by means of procurement terms, price control, and taxation would not eliminate entirely profiteering or inflation for the following reasons:

"1. Major accounting factors, such as costs and valuations, are extremely difficult to determine. To a large extent the government must rely upon industry for information. In the pressure of wartime, these accounting items are inevitably determined on a basis advantageous to industry.

"2. There are always many loopholes in profit-limitation schemes designed to apply uniformly to our immense and complicated industrial structure.

"3. No matter how effective a scheme may be on paper, it will be tremendously weakened by the administrative difficulties inherent in a wartime situation characterized by the necessity for speed and the vast volume of work which must be done.

"4. Because of the necessity for flexibility, the character of war regulation is largely determined by negotiation between government officials and industry. Industry inevitably has the upper hand in these negotiations because of its superior information and the existence of a seller's market in war."

In addition it expressed the fear that under one of the War Department bills a strict censorship of the press would be possible, while the President would have the power to fix wages throughout the country. Since the effort to limit prices or profits would probably be unsuccessful, employees would suffer unequally. Finally, it declared that according to the War Department plan labor, in fact, would be ordered "to either work or fight." Under this plan the control of labor would be "an outstanding industrial leader," and the proposed war

industries administration made no provision for any labor representation except in an advisory capacity. The proposal to register all male labor could be used to enforce a draft of labor and "to remove, in effect, the right of any laborer to refuse employment in private industry under conditions or at wages which did not satisfy his needs." Believing in the maintenance of democracy, the committee opposed any attempt in wartime "to draft civilian labor, directly or indirectly . . ."³⁴

Meanwhile the House had passed the McSwain Bill, which was referred by the Senate to the Nye Committee. The latter, recommending the rejection of the more important War Department bills, deleted all but the title in favor of its own proposals.³⁵

THE SENATE'S ATTEMPT TO KILL WAR PROFITS

The Nye bill provided that immediately upon the declaration of war a new tax schedule should enter into effect. A normal individual income tax of 6 per cent—an increase of 2 per cent—would be imposed, together with surtaxes rising to 93 per cent in cases of incomes in excess of \$20,000. Corporations would pay income taxes ranging from a minimum of 15 per cent to 100 per cent on incomes in excess of 6 per cent of the capital value of their stock. The primary purpose of such taxation, according to the committee, was to finance the war through taxation rather than borrowing—"taking the profit out of war" being incidental. Contrary to the custom followed after the war, tax returns could not be destroyed, while tax avoidance or evasion through improper write-ups in capital value and other methods were forbidden. The bill required the immediate registration of all business executives on the outbreak of war, and authorized the President to draft such executives for service in an Industrial Management Corps. Persons thus drafted would become members of the United States Army, subject to military discipline. They would receive compensation not to exceed that of Army officers, and could not receive any outside business income. An Industrial Management Board would have the power to requisition any plant, determining the amount of compensation which would be paid the owner, excluding loss of profits, but such com-

34. *Ibid.*, p. 5.

35. The original proposals drafted by Mr. John T. Flynn were even more drastic than the proposals finally reported in H.R. 5529, Calendar No. 2464. One summary provided for a surtax rate of 100 per cent on net incomes above \$10,000, and a maximum of 99 per cent on that part of corporation profits above 6 per cent. Cf. *To Prevent Profiteering in War*, Senate Report No. 577, 74th Cong., 1st session.

32. *Munitions Industry, Hearings*, cited, p. 3656; *Munitions Industry, Report on War Department Bills*, cited, p. 41.

33. *Munitions Industry, Report on War Department Bills*, cited, p. 10.

pensation would not have to be paid until 30 days after return of the plant—a provision of dubious constitutionality.³⁶ A Commodity Control Commission could close any commodity exchange, regulate commodity prices, and establish priorities. A War Finance Control Commission could veto the issuance of any security so as to divert capital into war industry. Both commissions would have revolving funds with which to purchase commodities and finance industry. Finally, the President was given a broad grant of power to fix prices, requisition any product or commodity, license production and transportation, and generally to promulgate rules against hoarding or profiteering.

When the Senate Military Affairs Committee received the Nye bill in May 1936, it referred the tax sections to the Finance Committee, and proceeded to consider the other sections. As a result of the deliberations of these two committees, the bill as reported out to the Senate on June 8 was considerably modified. The authors of the revised bill, believing that the wartime taxes should not be severe enough to hinder the production of war material or destroy the profit motive, reduced many of the taxes proposed by the Nye Committee. Although the normal income tax was increased to 10 per cent, surtaxes generally were lowered. For example, instead of adopting the maximum Nye figure of a 93 per cent surtax for incomes over \$20,000, it proposed 80 per cent over \$50,000.³⁷ It also eliminated the quarterly income returns called for by the Nye bill, considering them difficult to calculate; omitted the provision for publicity of tax returns; and granted permission to destroy tax returns after two years. As far as the Industrial Management and Commodity Control provisions were concerned, the President's freedom of action was increased. Under the Nye bill, all management personnel would be registered immediately after the outbreak of war; but the revised bill provided that such registration should take place only

when considered advisable by the President. The provision authorizing the Industrial Management Board to fix compensation for commandeered property was omitted.

Although critics insisted that the Finance Committee's changes would still make it possible for depletion, depreciation and amortization charges to be padded, the revised bill, it was believed, would go much further than the law in force in 1917-1918 to provide for payment of the war out of wartime profits. Moreover, it would not interfere with the prosecution of the war to as great an extent as the Nye bill, for high-cost producers whose production is essential in wartime would not be discouraged—as they might be by the virtual elimination of all profits. The 74th Session of Congress came to an end without any action being taken on the revised bill.³⁸

At the beginning of the 75th Congress Mr. Connally reintroduced his bill, representing the view of the Senate Finance and Military Committees, and so did Senator Nye on behalf of his colleagues on the Munitions Committee.³⁹ Although the two bills continued to differ in respect to wartime taxation, the Munitions Committee dropped its original proposals for drastic industrial conscription in favor of those acceptable to the Senate Finance and Military Committees.

DIFFICULTY OF TAKING PROFITS OUT OF WAR

Meanwhile, after authorizing Mr. Nye in the spring of 1936 to introduce his bill into the Senate, the Munitions Committee began to experience grave doubts as to the possibility of taking profits out of war.⁴⁰ In its final report, published in June 1936, it declared:

38. While the Nye Committee investigation was in progress, the War and Navy Departments set about modifying their Industrial Mobilization Plan and the accompanying legislative program, and in 1936 published a new version. (*Industrial Mobilization Plan, Revised, 1936*, cited.) An attempt was made to meet the Nye Committee's objections to labor controls. Thus, an "outstanding citizen" was substituted for an "outstanding industrial leader" as War Labor Administrator. The composition of the Labor Advisory Council was changed to add two members representing the public, thus obviating deadlocks between the representatives of industry and labor. The new plan is silent on the whole subject of labor controls exercised through the draft, which the Nye Committee had condemned. The Public Relations Administration, which the committee considered as a possible instrument of censorship, and the Selective Service Administration were also temporarily withdrawn pending revision of these sections of the plan. No solution is provided for the personnel problem, the plan merely stating that the War and Navy Departments are each to select and train "sufficient" personnel.

39. Cf. S. 1248; S. 1331.

40. *Munitions Industry, Report on War Department Bills*, cited, p. 3.

36. In the light of *United States v. New River Collieries*, 262 U. S. 34, and other cases, some legal authorities assert that the Fifth Amendment to the Constitution prohibits the taking of private property without fair compensation whether in time of peace or war, and declares that the courts decide what constitutes fair compensation. Cf. War Policies Commission, *Hearings*, cited, p. 839. To avert such dangers, the War Policies Commission recommended certain amendments. Cf. p. 19. The Munitions Committee discussed this question of constitutionality, but felt that the proposed constitutional amendments involved grave dangers, for the power of commandeering and taxing without uniformity would enormously increase the power of the Federal government. Cf. *Munitions Industry, Wartime Taxation and Price Control*, cited, p. 116. For a discussion of the constitutional question, cf. also *Industrial Mobilization Plan, Revised, 1936*, cited, Appendix VII.

37. Cf. H.R. 5529, 74th Congress, 2nd session, as reported by Mr. Nye with amendments, May 1, 1935, sec. 12.

"There are two reasons for believing that even theoretically full powers to eliminate profiteering actually would not be used for this purpose. (1) Industry, through its control over production, can strike against the government which is, in fact, in no position to commandeer any industry or plant, and thus force compliance with its wishes in regard to prices and contracts. (2) The control agencies must necessarily be administered by men who are industrially trained and presumably sympathetic to private industry's contentions."

Subsequently in the same report the committee states: "It is obvious that the most important contribution toward victory to be made in the economic sphere is the bringing about of the tremendous and rapid increase in production that is needed. Yet it is extremely unlikely that this production will be forthcoming without the evils of profiteering, mountainous debts, and inflation Whenever attempts to eliminate these evils conflict with the efforts to stimulate production, it is the former rather than the latter which must be sacrificed."

As far as price control and excess profits taxation are concerned, the committee was equally pessimistic. It declared that increase of costs would rapidly take place, owing to shifts of production to war purposes, the use of untrained labor to replace men drafted into the army and other reasons. "This means that no arbitrary plan of keeping all prices at a given level is practicable and individual prices must be fixed by government agencies."⁴¹ Inasmuch as governmental price control agencies must largely rely on industry for information as to costs, "the fixing of prices below such a level of profitability as the bulk of the producers in any industry agree is fair" is prevented. "The fact that costs are in the last analysis matters of opinion and are not susceptible of scientific determination, and the gigantic nature of the administrative task involved in enforcing any price provisions opposed by a substantial portion of industry makes it impossible to eliminate war profits by price control except to the extent that industry agrees to accept a limitation of its profit-making potentialities." Profits are large in peace time and the strain of war is not conducive to the adoption of fundamental reforms.

As far as heavy wartime taxation is concerned, the administrative burden, according to the committee, is excessive and resistance is great. Moreover, if "it reaches a level which the majority of business men feel is confiscatory," production will be discouraged. "Because of the difficulties of determining in any exact manner the costs of all business and hence the profits from business, and

41. *Munitions Industry, Wartime Taxation and Price Control*, cited, p. 6.

because of the impossibility of closing all loopholes in legislation designed to apply uniformly to our immense and complicated business and industrial structure, income taxation cannot eliminate all war profits."

Excessive taxation might discourage private investment required for increased production and thereby impose upon the government the responsibility for financial expansion, which would cost it far more than it would receive in taxation. As Lieutenant Colonel Harris testified: "I do not think we can fight a war unless we can depend on industry to meet us in fair agreements." Commenting on this sentence, the Munitions Committee declared: "It has been shown that the Government cannot necessarily get a fair deal from industry by depending upon voluntary cooperation. Yet it has no other alternative."

It is declared that even the efforts of Congress to limit the peace time profits of industries providing war materials to the government have proved difficult if not unsuccessful. Under a system of competition between such firms for government orders profits should be kept down. Nevertheless, the Senate Munitions Committee reported that in 1927, owing to the absence of competition among the shipbuilding companies, private shipbuilders made as much as 36 per cent profit on cruisers, while in 1929 and 1931 the profit was about 22 per cent. "The shipbuilders know that the Navy feels it has to have the ships and they raise the prices."⁴²

In 1934 Congress inserted in the Vinson-Trammel Act of March 22, 1934 a provision limiting profits on contracts for the building of naval vessels or aircraft to 10 per cent of the total contract price.⁴³ The Munitions Committee found, however, that

"the Navy, which has no responsibility for enforcing the act, and which has no reliable figures about private costs, is in a position to allow—and, according to one company, has actually allowed—increased overhead charges, which can invalidate the whole attempt by Congress to limit profits The committee finds that there is no enforcement of the profit limitation law in effect until four years after the beginning of a cruiser. It finds . . . enough evidence of the difficulty of auditing thousands of old vouchers and of properly

42. U. S. Congress, Senate, *Special Committee on Investigation of the Munitions Industry, Report on Government Manufacture of Munitions* (Washington, D. C., Government Printing Office, 1936), p. 8. Hereafter cited as *Munitions Industry, Report on Government Manufacture of Munitions*. This report declares that the cost of building a cruiser in a navy yard was \$2,116,304 less than in private yards in 1927, and \$1,843,693 less in 1929. For a denial, cf. p. 25.

43. Public—No. 135, 73rd Congress.

allocating overhead which the companies may have improperly saddled onto Navy vessels, to declare that there is no effective profit-limitation law today. It finds the price of real enforcement of the attempts of Congress to limit profits to be a costly policing force of accountants and auditors who would be in the yard for at least three years, and a series of costly lawsuits after those audits have been completed. It finds that the only way to prove that a company had not improperly allocated overheads from commercial jobs onto Navy jobs would be to audit all the commercial jobs being done by a private yard as well as the navy work"⁴⁴

Thus, the Senate Committee declared that the effort to limit profits rising out of peace time contracts between private navy yards and the government has proved a failure. If this is true, one may assume it will be much more difficult to limit such profits in time of war. Moreover, as the Munitions Committee declares, "the significance of these high prices and profits in war preparation during peace time is the probability that such prices and profits will be used as the basis of wartime profits and prices, and that the courts will insist upon their use to justify high wartime profits."⁴⁵

On the other hand, the National Council of Shipbuilders sharply denies the statements of the Nye Committee. While admitting that profits were unexpectedly high in 1927, it declares that "on a volume of business approximately \$2,200,000,000 over a long period of years, the average net profit to the industry including both commercial and naval work has been less than 5.5 per cent."⁴⁶ It also declares that over the last 25 years private industry has produced naval vessels at a lower cost to the government than have the public yards, and that the limitation on profits contained in the Vinson-Trammell Act is being enforced. It declares that the Senate Munitions Committee made no impartial effort to find the truth, stating that the committee

denied the National Council of Shipbuilders an opportunity to be heard.

The investigation of the Senate Munitions Committee seems to justify the following conclusions:

1. The outbreak of war means the establishment of a rigid dictatorship which may regiment labor, whether in industry or in the army, and may censor freedom of the press.

2. This dictatorship may not, however, be strong enough to take the profits out of war, whether by exercising supervision over procurement contracts, price fixing or heavy excess profit taxation, because of the danger of a strike of industry.

3. The greater the extent of peace time preparedness, the more difficult it will be for the government to limit the profits of private munition firms in peace time—profits which will inevitably increase upon the outbreak of war.

Theoretically, one escape from this dilemma is through the formula of government ownership. Were the manufacture of war materials a government monopoly, the increase of munitions would be possible without involving profiteering by private enterprise. The committee majority—Senators Nye, Clark, Pope and Bone—recommended government ownership of the facilities necessary to construct instruments of war for the Navy and War Departments. It expressed the belief that the two service departments could produce from their own ranks or employ sufficiently able technicians to operate these plants successfully, and that the wartime mobilization of munitions industries could be carried on in the same way as under the present system. Salaries for the technicians would be comparable to those paid in private industry.

"The plan as proposed by the committee majority looks forward to an adequate munitions plant to supply the peace time needs only of the Army and Navy and procurement by the military services of sufficient tools and equipment so that installation of them in private plants may be undertaken in time of war It does not plan large munition plants The Navy could enlarge its facilities to produce all the ships necessary for a considerable naval race at a cost for those facilities of as little as \$23,600,000, including sufficient machinery to modernize the yards and produce ships even more efficiently than at present.

"The committee majority does not see any danger to overproduction in Government plants, since the manufacture of the Army's guns and rifles and the Navy's powder and ships have not, according to any service officials, resulted in overloading the services with matériel."⁴⁷

47. *Munitions Industry*, Senate Report No. 944, Part 3, p. 16. In 1934 War Department representatives informed Congress that it would cost \$496,000,000 for plants running on a one-shift basis to supply a million men through the first year of war and equip part of a second million men.

44. *Munitions Industry*, Senate Report No. 944, Part 7, p. 12.

45. *Munitions Industry, Report on Government Manufacture of Munitions*, cited, p. 3. A further example of this type of dispute is found in the difficulty of the government in inducing private industry to bid for naval fuel, oil and steel, in the light of the provisions of the Walsh-Healey Act, forbidding any government contract of more than \$10,000 with any firm which does not pay "prevailing wages," or does not follow the 40-hour week, or which employs child labor, unless the Department of Labor authorizes an exception. In February 1937 it was revealed that work on 6 destroyers and 3 submarines had been halted owing to the inability of the government to purchase steel. On March 16 it was announced that numerous bids were again being received, apparently because some steel companies had accepted the 40-hour week as a result of negotiations with the C.I.O. *New York Times* and *New York Herald Tribune*, March 17, 1937.

46. National Council of American Shipbuilders, *Commercial Shipyards and the Navy* (New York, 1937), pp. 68, 78, 99, 105.

The minority of the committee — Senators George, Vandenberg and Barbour—questioned the complete nationalization of munitions, doubting the advantage of such a policy from the standpoint of (1) its effect on disarmament, (2) its effect on essential national defense, (3) its effect on government costs.

"The committee minority believes that if large Government plants are erected to provide these commodities, there will be inevitable local political pressure to maintain these plants at full capacity production regardless of actual defense needs, and the result will be to encourage armament rather than disarmament If all production be thus concentrated in Government plants, furthermore, there will be no adequate corollary reliance, through private manufacture, in the event of a war emergency unless the nationalized facilities are maintained at a needlessly extravagant and dangerous rate during peace time Unless these facilities are kept on a full-time production basis during peace years, the unit cost of production will increase to a point which will create higher costs to the Government than would be available through normal, private purchase" ⁴⁸

There may be arguments on behalf of government manufacture of munitions, but it would seem obvious that such a proposal would not solve the problem of "taking profits out of war." For the war of the future will involve nearly every industry in the country—and not alone the so-called munition factories. If government ownership is regarded as the solution of the problem, it must be extended generally.

A second escape from the dilemma mentioned above is to reduce the danger of an overseas war by reorganizing the country's defenses on a purely continental basis. Nevertheless, the National Defense Act of 1920 and the war mobilization plan assume that the United States will again send abroad a huge expeditionary force and that an industrial preparedness program should be shaped with this end in view. The War Department before the Senate munitions investigation also assumed that a general draft act similar to that enacted in 1917 would again be passed. Commenting on these plans, the Munitions Committee implied that if the War Department was preparing for another overseas war, "it is of the utmost importance for Congress and the country to know it." ⁴⁹⁻⁵⁰

Despite the fundamental importance of the nature of our preparedness program,⁵¹ the Munitions

Committee did not feel authorized to make recommendations concerning it. It merely proposed that in the 1938 election a national referendum be held "on the military draft of men for service outside continental America."⁵² Even though the United States reorganizes its military establishment purely on a basis of continental defense and adopts severe "neutrality" legislation, the difficulties of keeping out of a general war, whether in Europe or Asia, admittedly are great. It is logical to conclude, therefore, that the only solution is to avert the outbreak of war by a constructive policy of international cooperation. Nevertheless, most of the members of Congress responsible for the "take the profit out of war" movement remain silent as to these fundamental remedies.

ANALYSIS OF PENDING LEGISLATION

Despite evidence that the only sure way of taking profit out of war is to keep out of war, Congress is now considering bills which assume that it is possible to solve the war profit question directly. There are two important groups of bills having this purpose. The first is the Sheppard-Hill bill, sponsored by the American Legion and now introduced by the chairmen of the Military Affairs Committees of the House and Senate, which virtually makes it an Administration measure. This bill authorizes the President in time of war to draft men into military service, and establish control over material resources and industrial organization. The bill also imposes a blanket tax of 95 per cent on war profits. It differs from the McSwain bill which passed the House last year in that it authorizes military conscription but does not grant the President power to commandeer industry. ⁵³⁻⁵⁴

The second group of bills, introduced respectively by Senators Nye and Connally, are an outgrowth of the work of the Senate Munitions Committee. Both bills now agree in granting the President wide powers over the industrial system in wartime, but they differ on the type of war taxation to be imposed. Although the Connally bill would jump the normal individual income tax from 4 to 10 per cent, the Nye bill would increase it only to 6 per cent. The Nye surtaxes in the up-

48. *Munitions Industry*, Senate Report No. 944, Part 3, p. 17. Cf. also *Commercial Shipyards and the Navy*, cited.

49-50. *Munitions Industry*, Report on War Department Bills, cited, p. 11. Cf. also *ibid.*, Report on Government Manufacture of Munitions, cited, p. 63.

51. For a plea for a continental defense system, cf. Major General Johnson Hagood, *We Can Defend America* (New York, Doubleday, Doran, 1937).

52. *Munitions Industry*, Report on War Department Bills, cited, p. 5.

53-54. This power is already granted, however, in Section 120 of the National Defense Act.

per, brackets, however, are considerably higher than the Connally surtaxes.⁵⁵

For purposes of simplification, the Sheppard-Hill bill will be called Bill No. 1, and the Nye and Connally bills, Bills No. 2. According to section 3 of Bill No. 1, the President may draft men into military service "in the event of war, or of a national emergency declared by Congress to exist." Thus a President might induce Congress to declare that serious labor trouble constituted such an emergency; or he might conceivably produce a situation which would lead Congress to declare war against a small country—as a pretext to mobilize man power in support of the establishment of a dictatorship at home.⁵⁶ Bills No. 2 contain no authorization for military conscription either in the event of war or national emergency, apparently in the belief that even if war is declared, Congress should exercise its own judgment whether conscription is desirable under the circumstances.

The vast powers over industry granted to the President in Bill No. 1 enter into effect "whenever Congress shall declare war or the existence of an emergency due to the imminence of war." Bills No. 2 declare, however, that the war powers of the President may be applied only when Congress states "that the existence of a 'state of war' creates a grave national emergency." Thus Bills No. 2 provide for a greater degree of legislative control over Presidential war power than does Bill No. 1. On the other hand, Bill No. 1 seems to give the President less power in regard to industrial conscription than do Bills No. 2. While Bill No. 1 authorizes the draft of industrialists, they are to serve merely as "civilians," in contrast to Bills No. 2 which provide that industrialists thus drafted shall be subject to the jurisdiction of the War Department, although the latter cannot interfere in the internal management of the factory concerned. While Bills No. 2 prohibit drafted industrialists from accepting outside compensation or participating in the determination of any question affecting personal or business interests, Bill No. 1 is silent in regard to this matter, leaving it to

55. The Nye bill imposes on a corporation a tax of 15 per cent if its net income is not in excess of 2 per cent of the adjusted declared value of its capital stock, which rises to 100 per cent of such portion of its net income as is in excess of 6 per cent of such value. The Connally bill, on the other hand, provides for an undistributed profits tax, apparently designed to force out to the stockholders practically all of the current earnings of a corporation. Thus if the corporation pays out in dividends 100 per cent of the adjusted net income, no tax at all on such income is imposed; but if it pays out only 10 per cent in dividends, then it is to pay a tax equal to 69 per cent of its adjusted net income.

56. Cf. Stephen Raushenbush, "Kill the Conscription Bill," *The Nation*, February 27, 1937.

the discretion of the President. In effect, both bills grant the same price-fixing powers to the President; both give him authority to requisition materials for use or resale by the government, to license private enterprise and to establish priorities. But Bills No. 2 go further and authorize the President to "requisition" or "take possession" of any property, on the understanding that the owner will be "justly compensated" for any loss not including the loss of profits. If such compensation is not satisfactory, the person concerned would be paid 75 per cent thereof, and be entitled to sue the United States at the close of the war for any further sum. Bills No. 2 authorize large revolving funds with which the President can make purchases of commodities or loans to war industries. They also authorize the President to close the commodity and security exchanges, and provide for a war finance commission with power to veto loans not compatible with the prosecution of the war. Although Bill No. 1 does not give the President power to "requisition" property, its general grant may be wide enough to authorize him to purchase commodities, make war loans to industry, and close the exchanges.

Neither bill contains any provisions authorizing the drafting of labor or press censorship. Nevertheless, both contain provisions which might be interpreted to authorize these practices. Thus Bill No. 1 authorizes the President to establish "control" over any "material resources, industrial organizations and public services," and to license any classes of "right"; while Bills No. 2 authorize the registration of any person engaged in the "management or control of any technical, industrial or manufacturing plant or establishment of any kind whatsoever," which possibly may be interpreted to include certain types of labor leaders in plants having collective bargaining, as well as editors. Moreover, Bills No. 2 authorize the President to license the production or distribution of any "right"; and in the event of "a labor dispute," to requisition the physical establishment or resources of the plants concerned "and operate it under such rules and regulations as he may deem proper in the circumstances, and with such personnel as he may deem suitable to best subserve the interests of the nation in the successful prosecution of war."

As far as war taxes are concerned, the rates in the Sheppard-Hill bill are ostensibly higher than the rates in the Nye and Connally bills. All three bills provide for war taxes ranging from 80 to 95 per cent on certain types of war incomes. Some tax experts believe, however, that any tax of more than

50 per cent is likely to break down or be evaded.⁵⁷ Bill No. 1 declares that the 95 per cent war profits tax shall be based on all income "above the previous three-year average, but with proper adjustments for capital expenditures for war purposes by existing or new industries." This general provision is open to the criticism that profits made during the previous three-year average may have been excessive. This might be particularly true in the case of corporations which develop a war trade with belligerents during a period in which the United States remains neutral.⁵⁸ Serious differences may also arise over the amount of capital expenditure for war purposes. Consequently it is contended that instead of taking the profit out of war, the Sheppard-Hill bill in effect guarantees to private enterprise an additional 5 per cent profit should war take place, and particularly because companies producing for war purposes do so virtually without risk.

While those who favor strict control over industry find much to criticize in these bills, those who believe in the effective prosecution of the war and fear arbitrary government power also have ground for apprehension. The very fact that the powers granted to the President are subject to wide differences of interpretation increase the possibility that the President may exercise them so as arbitrarily to injure private enterprise. Thus it is possible to believe that the tax provisions of both sets of bills may be applied in a confiscatory sense. The attempt of the Connally bill to force practically all the current earnings of a corporation out to the stockholders may have serious consequences of an economic and a social nature; while the effort of the Nye bill to use the adjusted declared capital stock value as the basis for estimating war incomes is so vague as to open the door to abuse, the danger of which is heightened by the very size of the surtax rates.⁵⁹ The War Department has pointed out in its examination of the pending bills, that "tax provisions must not be of such a drastic na-

ture as to hinder, hamper, or destroy the more important mission of producing munitions as required in war."⁶⁰

Whether these bills open the door to wartime dictatorship is a matter of indifference to many observers. In their opinion, such a dictatorship is inevitable in case the United States becomes involved in another general war; and any attempt to erect safeguards in peace time to protect capital, labor or the press is doomed to failure. Others declare, however, that even if this is true, it does not follow that Congress should now authorize the establishment of a war dictatorship. The only result, in their opinion, would be to increase the forces moving in the direction of dictatorship, and at the same time lay the basis for increased preparedness. The War Department in its 1936 Annual Report declared:

"If a bill embracing the matters covered in H.R. 5529 is enacted into law, there will be, for the first time in our history, legislation on the statute books empowering the War and Navy Departments to formulate plans for the wartime mobilization of industry founded on basic law. If the industrial control measures authorized by this bill are promptly initiated and wisely administered, they will help the country to pass promptly and smoothly to a war footing and will tend to shorten the duration of the conflict. The cost to the nation will be materially lessened and much of the disastrous aftermath of war will be avoided."⁶¹

The pending bills, as the War Department stresses, may give a legal basis for the industrial mobilization plan which it has already put into effect, as well as increase the whole policy of industrial preparedness. The wisdom of such a preparedness program may be argued on its merits; nevertheless, it is a paradox that a nation-wide movement to take the profit out of war should end in proposals to help the country, as the War Department states, "to pass properly and smoothly to a war footing," as well as to establish a dictatorship bearing much more severely on the press and labor than on industry. It is also a paradox that, although the Senate Munitions Committee pointed out all these dangers and demonstrated the almost insuperable difficulties in taking the profit out of war under our present economic system, its members should continue to support measures which may accentuate the very dangers the committee supposedly wished to avoid.

57. Professor Haig, *Taxation of Excess Profits in Great Britain, 1920*, quoted in *Munitions Industry, Wartime Taxation and Price Control*, cited, p. 12.

58. Mr. Raushenbush, Secretary of the Munitions Committee, writes: "Under this tax, the du Pont Company would not have paid a penny to the government in 1917 or 1918." Cf. "Kill the Conscription Bill," cited.

59. Cf. a forthcoming survey, "Facing the Tax Problem," directed by Prof. Carl Shoup for the Twentieth Century Fund. For the difficulty of measuring excess profits on the declared value of capital stock, rather than on the capital investment, cf. H. L. Lutz, *Public Finance* (New York, Appleton, Century, 1936; 3rd ed.), p. 623.

60. *Industrial Mobilization Plan, Revised, 1936*, cited, p. 62.

61. *Report of the Secretary of War, 1936*, cited, p. 23.